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published in
International Journal of Auditing
2012

DOI (link to publisher)
10.1111/j.1099-1123.2012.00452.x

document version
Peer reviewed version

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International Journal of Auditing, 16(3), 286-307

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Anna Gold*
VU University Amsterdam
anna.gold@vu.nl

Ulfert Gronewold
Universität Potsdam
ulfert.gronewold@uni-potsdam.de

Christiane Pott
Westfälische Wilhelms-Universität Münster
christiane.pott@wiwi.uni-muenster.de

*** Corresponding author.** Department of Accountancy (PGO); Faculty of Economics and Business Administration; VU University Amsterdam; De Boelelaan 1105; NL-1081 HV Amsterdam; The Netherlands; Tel: +31 20 59 82592

This project is part of the Auditing Standards Board and International Auditing and Assurance Standards Board sponsored research on "Unqualified Auditor's Report Communications." We are grateful for the opportunity to be part of this research initiative and appreciate the funding and research support provided. We thank Douglas Prawitt, Mark Taylor, Stuart Turley and participants at the 5th EARNet Symposium 2009 in Valencia (where this paper won the Best Paper Award), as well as members of the Auditing Standards Board and members of the International Auditing and Assurance Standards Board for valuable comments, the Institute of German Auditors (IDW), two Big 4 audit firms, the Society of Investment Professionals in Germany (DVFA), and the London School of Economics for research support. Finally, we thank Evelien Smits for her programming assistance and translation work. All remaining errors are our own.

The ISA 700 Auditor's Report and the Audit Expectation Gap – Do Explanations Matter?

ABSTRACT: In this paper we test the effectiveness of explanations as mandated by the revised ISA 700 auditor's report in reducing the audit expectation gap. German auditors and financial statement users participated in an experiment where they read a summary of a firm's financial statements and an auditor's report, the latter of which we manipulated as being the auditor's report including the explanations as mandated by ISA 700 versus a mere audit opinion-only version. We elicited participants' perceptions about auditor versus management responsibilities and financial statement reliability.

We find strong evidence for a persistent expectation gap with respect to the auditor's responsibilities. Meanwhile, auditors and users reach a reasonable belief consensus regarding management's responsibilities and financial statement reliability. Most notably, explanations of the ISA 700 auditor's report do not result in a smaller expectation gap. Our findings suggest that the mere audit opinion may signal sufficient relevant information to users.

Key words: Audit expectation gap, auditors, financial statement users, financial analysts, students, auditor's report, responsibility perceptions, reliability perceptions.

SUMMARY: In response to repeated observations of an audit expectation gap between financial statement users and the audit profession, the International Accounting and Assurance Standards Board (IAASB) released a revision of the International Standard on Auditing (ISA) 700, the standard on the auditor's report, which is effective for reports dated on or after December 31st, 2006. The revision was undertaken in order to improve users' understanding of an audit and to align users' expectations with the actual responsibilities of the auditor and management as well as the reliability of audited financial statements (IFAC, 2008). This revision of ISA 700 primarily featured the inclusion in the report of explanations of auditor versus management responsibilities and of the nature, scope, and procedures of the audit. This raises the question whether such explanations do in fact result in any smaller expectation gap than when no further explanations are offered in the report. Hence,

the purpose of this paper is (1) to determine the current state of the expectation gap under the revised ISA 700 auditor's report, and (2) to test whether the presence versus absence of explanations in the auditor's report as mandated by the revised ISA 700 results in a smaller expectation gap.

We report the results of an experiment in which experienced German auditors and financial statement users (i.e., financial analysts and business students) read a brief company description, a summary of the firm's financial statements, and an auditor's report, the latter of which we manipulated as being either the auditor's report including the explanations as mandated by the revised ISA 700 or a mere audit opinion-only version. Participants then responded to questions related to the perceived responsibility of the auditor versus management for the financial statements and questions about the reliability of the audited financial statements.

We find strong evidence for a persistent audit expectation gap between auditors and financial statement users under the revised ISA 700 auditor's report with respect to the auditor's responsibilities. Meanwhile, auditors and users reach a reasonable belief consensus regarding management's responsibilities and financial statement reliability. Most notably, the explanations of the ISA 700 auditor's report of auditor versus management responsibilities and of the nature, scope, and procedures of the audit do not result in a smaller expectation gap. Our findings suggest that the mere audit opinion may already signal sufficient relevant information to financial statement users.

Overall, while the fact that an audit expectation gap still exists under the new ISA 700 auditor's report is in line with our expectations, it is disconcerting that the rather detailed explanations of auditor versus management responsibilities do not favourably affect the gap. This observation may indicate that the explanations would need to be formulated more explicitly and clearly, or even that users' perceptions are simply not malleable by additional information and explanations in the auditor's report.

The ISA 700 Auditor's Report and the Audit Expectation Gap – Do Explanations Matter?

1. INTRODUCTION

The issuance of an unqualified audit opinion implies that the auditor believes that the financial statements give a true and fair view in accordance with the applicable financial reporting framework (IFAC, 2008). Prior research demonstrates that financial statement users (such as bankers, investors, and financial analysts) often associate an absolute level of assurance when they read such messages, potentially resulting in naïve or unreasonable expectations (e.g., Epstein & Geiger, 1994). However, in reality, the auditor merely provides a *reasonable* level of assurance (e.g., Hasan *et al.*, 2005), as inherent audit limitations prevent the auditor from achieving *absolute* assurance (Gay *et al.*, 1998). Furthermore, financial statement users (henceforth called 'users') often assume audits to have a broader scope than they actually have. For example, users may erroneously associate audits with an approval of management adequacy, a guarantee of the absence of fraud, and a recommendation to invest in the respective firm (Frank *et al.*, 2001). Prior studies (e.g., Bailey *et al.*, 1983; Nair & Rittenberg, 1987; Anderson *et al.*, 1998) have also found that users attribute disproportionate responsibility toward auditors, whereas in reality, management (rather than the auditor) is primarily responsible for the adequacy of the financial statements. These and other differences between what users expect from the auditor and what the auditor actually provides have become known as the *audit expectation gap*.[1]

In response to this problem, the International Accounting and Assurance Standards Board (IAASB) released a revision of the International Standard on Auditing (ISA) 700, the standard on the auditor's report, which is effective for reports dated on or after December 31st, 2006. With this revision, the IAASB mandates a new wording for the auditor's report that includes explicit explanations of the responsibilities of management and the auditor and of the nature, scope, and procedures of the audit (IAASB, 2004). The first objective of our study is to empirically assess the current state of the expectation gap in Germany given the

[1] For conceptual inquiry into the expectation gap see Dennis (2010b); for a critical debate on the effectiveness of the audit function given the presence of an expectation gap see Humphrey and Owen (2000).

revised ISA 700 auditor's report. To this end, users (financial analysts as sophisticated users and business students as unsophisticated users) and experienced auditors were asked to read an unqualified ISA 700 auditor's report in its revised form and to respond to questions about the responsibilities of the auditor and management and the reliability of the audited financial statements.

The revised ISA 700 requires the auditor's report to provide explicit explanations of the auditor's versus management's responsibilities, along with an explanation of the nature, scope, and procedures of the audit. The revision was undertaken in order to improve users' understanding of an audit and to align users' expectations with the actual responsibilities of the auditor and management as well as the reliability of audited financial statements (IFAC, 2008).[2] This recent revision of ISA 700 raises the question whether financial statement users pay attention to such explanations and whether these explanations do in fact result in a smaller audit expectation gap as compared to the absence of such explanations in the report. Prior research partly suggests that specific wording in the auditor's report may lead to a better understanding of the scope, nature and significance of audit procedures (e.g., Bailey *et al*., 1983; Manson & Zaman, 2001; Chong & Pflugrath, 2008), but there is also evidence suggesting only moderate, undesired, or even no effect at all (e.g., Humphrey *et al.* 1992; Brown *et al.* 1993; Monroe & Woodliff 1994; Kneer *et al.* 1996; Schelluch 1996; Chong & Pflugrath 2008; Humphrey *et al.* 2009). Hence, the second purpose of the current study is to provide empirical evidence on whether the presence of explanations in the auditor's report as mandated by the revised ISA 700 results in a smaller expectation gap as compared to the absence of such explanations in the report. We use the "strongest" experimental manipulation possible, which compares perceptions formed on the basis of the complete auditor's report that includes the explanations as mandated by the revised ISA 700 on the one hand versus a version without any further explanations (i.e., an opinion-only version) on the other. A reduced gap in expectations on the basis of the complete auditor's report would indicate a positive effect of the presence of explanations that accompany the audit

[2] All European Union (EU) member states are required to replace their existing national auditor's reports with the new format as soon as the European Commission adopts an international auditing standard that covers the same subject matter as a national standard (European Parliament and Council, 2006). In Germany, the implementation of the ISA 700 into IDW PS 400 is currently being undertaken. For the purposes of this study, the unpublished draft version of the German translation of the ISA 700 was used, which was kindly provided by the Institute of German Auditors (IDW).

opinion in the revised ISA 700 auditor's report. In contrast, an unchanged gap would indicate that the explanations beyond the audit opinion are ineffective, possibly suggesting that the mere audit opinion might signal sufficient relevant information to users.

The results of our experiment among experienced German auditors and users with varying levels of sophistication provide strong evidence for a persistent audit expectation gap under the revised ISA 700 auditor's report in some areas (auditors' responsibilities), while auditors and users reach a reasonable belief consensus with respect to other areas (management's responsibilities and financial statement reliability). Notably, the explanations of the ISA 700 auditor's report do not have an effect on the gap between auditors' and users' expectations and perceptions.

Our findings are important for at least the following reasons. First, to our knowledge, this is the first study to investigate the expectation gap under the revised ISA 700 in a European country. Prior expectation gap research has largely focused on Anglo-Saxon countries such as the US, UK, New Zealand, and Australia (e.g., Gay *et al.*, 1997; 1998; Dewing & Russell, 2002; Kirk, 2006; Chong & Pflugrath, 2008) and Asian countries such as Singapore, China, Bangladesh, and Lebanon (e.g., Best *et al.*, 2001; Lin & Chen, 2004; Sidani, 2007; Siddiqui *et al.*, 2009).[3] Second, we inquired among a substantial range of different groups dealing with financial statements and audit opinions, including experienced auditors, financial analysts as sophisticated users, and business students as unsophisticated or "naïve" users. This approach allowed us to capture the impact of different levels of user expertise and, thus, to investigate the expectation gap in a differentiated way. Third, in light of rather mixed prior evidence, our findings provide insight into whether financial statement users pay attention to explicit explanations of auditor versus management responsibilities and of the nature, scope, and procedures of the audit included in the report, and whether the presence (versus absence) of such explanations results in a smaller expectation gap. To our knowledge, we are the first to investigate such an effect based on the revised ISA 700.

[3] Spanish evidence on the usefulness of the auditor's report to make investment and lending decisions is provided by Duréndez Gómez-Guillamón (2003). Instead of investigating the persistence of the audit expectation gap after an unqualified auditor's report, he compares the effect of different audit opinions (i.e., clean, qualified, adverse or disclaimer).

This paper is organized as follows. The next section reviews the literature and develops our hypotheses. Section 3 describes the research method, the results are presented in section 4, and section 5 provides a summary and discussion of the results.

2. DEVELOPMENT OF HYPOTHESES AND RESEARCH QUESTIONS

2.1 Persistence of the audit expectation gap (H1)

One of the first studies on the expectation gap was conducted by Libby (1979), who investigated bankers' and auditors' perceptions of the message communicated by the auditor's report. Libby found that the perceptions of both groups were relatively similar to the intended communication. In contrast, Nair & Rittenberg (1987) observed that bankers placed greater responsibility for the completeness and accuracy of the financial statements on auditors and less responsibility on management than CPAs did. Houghton (1987) compared shareholders' and accountants' perceptions of the phrase "true and fair view" and found significant differences between the two groups.

Lowe (1994) was the first researcher to compare perception differences between auditors and judges. Lowe found a large divergence in perceptions regarding their expectations of the auditing profession. Similarly, Frank *et al*. (2001) compared auditors', accounting students', and jurors' attitudes toward the accounting profession. A large difference in perceptions existed between auditors and jurors, whereas accounting student responses were very similar to auditor responses. Despite efforts by the accounting profession to explicitly differentiate management's responsibilities for the financial statements from the auditor's role in expressing an opinion, jurors ascribed greater responsibility to auditors. Studying perceptions related to various dimensions of the attest function, McEnroe & Martens (2001) found that investors had higher expectations for various facets and assurances of the audit, compared to auditors. Reckers *et al.* (2007) examined the attitudes of judges, law students, MBA students, and auditors toward the public accounting profession over time and found that auditors' attitudes were more favourable than those of the other three groups. More recently, Butler *et al*. (2010) investigated auditors' and investors' perceptions of the intended meanings of key terms used to define auditors' responsibilities. They found differences between auditors and investors, indicating an expectation gap.

Non-US evidence also suggests the existence of an expectation gap. For example, Best *et al*. (2001) found evidence of a wide audit expectation gap among

auditors, bankers, and investors in Singapore concerning several areas of auditor responsibility. Comparing perceptions of accountants, corporate finance directors, investments analysts, bank lending officers, and financial journalists from the UK, Humphrey *et al*. (1993) demonstrated the existence of an expectation gap in a variety of aspects, in the nature of the audit function and the perceived performance of auditors. Research from Australia and New Zealand also supports these findings (Porter, 1993; Gay *et al*., 1997; 1998). A somewhat different research approach was used by Öhman *et al.* (2006) in a study of Swedish auditors' practices. They found that auditors devoted more resources to areas that were easily verified and fewer resources to areas perceived to be of importance to primary stakeholders.

In conclusion, the expectation gap appears to be a persistent phenomenon across time and national borders, despite several institutional changes implemented over the last several decades. Given these findings, we expect that the likelihood of the revised ISA 700 auditor's report to narrow the expectation gap will be rather limited. Therefore, we hypothesize that users will still ascribe relatively more responsibility to the auditor as compared to auditors themselves, even when they are exposed to the revised version of an unqualified ISA 700 report. While auditors are knowledgeable about their actual role of merely providing assurance on financial statements for which management is primarily responsible, prior research confirms that users may have unrealistic expectations about the auditor's task and responsibilities relative to the responsibilities of management. Therefore, we expect that users' responsibility ascriptions toward management will be relatively lower compared to the responsibility ascriptions of auditors. Furthermore, because auditors as compared to users are better aware of the inherent limitations of an audit and an unqualified auditor's report, we expect that they ascribe less reliability to audited financial statements than do users.

> **H1a:** Users (i.e., students and financial analysts) of financial statements with an unqualified ISA 700 auditor's report ascribe relatively more responsibility for the financial statements to the auditor than auditors do.
>
> **H1b:** Users (i.e., students and financial analysts) of financial statements with an unqualified ISA 700 auditor's report ascribe relatively less responsibility for the financial statements to management than auditors do.

H1c: Users (i.e., students and financial analysts) of financial statements with an unqualified ISA 700 auditor's report ascribe relatively more reliability to the underlying financial statements than auditors do.

2.2 Effect of users' sophistication on the audit expectation gap (H2)

Prior literature on the auditor's report has involved participants with different sophistication (i.e., experience and knowledge levels) in the area of financial reporting (e.g., bankers, jurors, and students). Overall, research has found that more knowledgeable users place less responsibility on auditors than less knowledgeable users. These results indicate differences in the size of the expectation gap, depending on the experience and knowledge of potential users (e.g., Bailey *et al.*, 1983; Humphrey *et al*., 1993; Manson & Zaman, 2001). Similarly, Monroe & Woodliff (1993) studied the influence of education on the expectation gap. They surveyed auditors and undergraduate students, who were either uneducated or educated in auditing. There were fewer differences between the auditors and the educated students in comparison to the uneducated students, suggesting an education effect on the expectation gap. Similarly, Gay *et al*. (1997) reported that users with considerable business experience had more moderate expectations of auditors' responsibilities and perceptions that were closer to those of the auditing profession when compared to less experienced users. In contrast, Gramling *et al*. (1996) found no evidence of an education effect (completion of an undergraduate auditing course) on the audit expectation gap between students and auditors.

Another set of studies measured the effect of knowledge or education on the audit expectation gap by means of experimental manipulation, e.g., by offering extra educational materials to a subsample of users. Such reading material helped educating Malaysian users and corrected some misconceptions related to the audit expectation gap (Fadzly & Ahmad, 2004). Similarly, evidence from Bangladesh suggests that audit education significantly reduces the audit expectation gap as it relates to financial statement reliability (Siddiqui *et al*., 2009).

Because most prior research finds experience and knowledge effects on the size of the expectation gap, we divided our sample of financial statement users into financial analysts and students, in order to control for this effect and determine whether it holds for the revised ISA 700 auditor's report. Financial analysts are specialized in financial statement analysis and company data interpretations. Given

their comprehensive practical experience with audited financial statements, they should at least have a moderately sophisticated knowledge of the implications of an auditor's report. Students were chosen to represent the individual unsophisticated investor, who has less practical experience with financial statements and auditor's reports. We selected students from business and economics programs, who have not specialized in the area of auditing, because they are somewhat familiar with financial statements but do not have detailed formal knowledge about auditing and auditor's reports (as should be the case with typical unsophisticated investors in real-world markets). Our second hypothesis is stated in three parts as follows:

> **H2a:** The difference in perceptions of the unqualified ISA 700 auditor's report between unsophisticated users (students) and auditors is relatively greater compared to the difference between sophisticated users (financial analysts) and auditors regarding the extent to which responsibility for the financial statements is ascribed to the auditor.
>
> **H2b:** The difference in perceptions of the unqualified ISA 700 auditor's report between unsophisticated users (students) and auditors is relatively greater compared to the difference between sophisticated users (financial analysts) and auditors regarding the extent to which responsibility for the financial statements is ascribed to management.
>
> **H2c:** The difference in perceptions of the unqualified ISA 700 auditor's report between unsophisticated users (students) and auditors is relatively greater compared to the difference between sophisticated users (financial analysts) and auditors regarding the extent to which reliability is ascribed to audited financial statements.

2.3 Effect of explanations on the audit expectation gap (RQ1)

Prior research has examined the effect of wording differences in the auditor's report on the expectation gap. While one stream of research explores the alterations in readers' perceptions after a revision of the relevant auditor's report standard (e.g., Bailey *et al.*, 1983), a second stream addresses the effect of different types of auditor's reports on readers' perceptions (e.g., Holt & Moizer, 1990). A third stream investigates the impact of additional information provided to the reader, such as

comparing longer versus shorter auditor's reports (e.g., Miller *et al*., 1993; Humphrey *et al.*, 1992; 2009).

Early research by Bailey *et al.* (1983) showed that the American Institute of Certified Public Accountants' *(*AICPA) proposed wording changes shifted readers' perceptions of the responsibility for financial statements from the auditor toward management in the desired way. Similarly, the new Statement on Auditing Standards (SAS) no. 58 auditor's report led to an increase in understandability regarding the purposes of the audit and the responsibility of management for the financial statements (Kelly & Mohrweis, 1989). Miller *et al.* (1993) compared bank loan officers' perceptions of a new auditor's report based on SAS no. 58 and found that loan officers who read the new auditor's report were better able to identify the responsibilities assumed for the financial statements by both management and the auditors compared to loan officers who read the old auditor's report.

In the early 1990s, the Australian Accounting Research Foundation (AARF) proposed a new wording for their standard auditor's report with the issuance of the Statement of Auditing Practice (AUP) no. 3, which followed the US example of SAS no. 58. Monroe & Woodliff (1994) investigated the effect of the proposed wording changes by surveying auditors and various types of users. After establishing the existence of the gap under the old form of the auditor's report, the researchers found that the new version eliminated some of the differences in perceptions (e.g., regarding the auditor's responsibilities), but also created new differences, especially in areas not mentioned in the auditor's report (e.g., fraud prevention). Kneer *et al*. (1996) confirmed that the language of the auditor's report can influence users' perceptions of auditors' responsibilities and that the improved language in SAS no. 58 "achieved modest success in this regard" (p. 25).

In the UK, Holt & Moizer (1990) studied the auditor's report by investigating the extent to which auditors and sophisticated users distinguished between various reports. Their results indicated disagreement between the two groups concerning the unqualified auditor's report. This disagreement was related to both the meaning of the unqualified auditor's report and the interpretation of the qualifications used by auditors. In particular, users perceived going-concern qualifications to be more serious than did auditors. Miller *et al*. (1993) found that bankers considered a longer report to be more useful and understandable as compared to a short-form report. Similarly, the purpose of Hatherly *et al*.'s study (1991) was to disentangle whether

different meanings were attached to a complete versus short-form unqualified auditor's report (using a UK derivative of the SAS no. 58 standard auditor's report). Only a complete auditor's report changed readers' perceptions. This is consistent with Schelluch (1996), who found that the expectation gap regarding auditor responsibilities was diminished with the introduction of a complete auditor's report. However, a complete report did not reduce the expectation gap regarding perceptions of financial statement reliability. Innes *et al*. (1997) concluded that an expanded SAS 600 report would allow the audit profession to enhance its status without any change in actual audit activities or auditor accountability. Similarly, Koh & Woo (1998) observed a better understanding of the scope, nature, and significance of the audit with a complete report.

In contrast, recent Australian evidence showed that more detailed descriptions of the respective responsibilities did not result in a reduction of the expectation gap, whereas placing the audit opinion at the beginning of the report appeared to have some beneficial consequences on users' perceptions (Chong & Pflugrath 2008). Similarly, Brown *et al*. (1993) found that an expansion of the auditor's report actually *increased* the number of differences perceived by users.

Humphrey *et al.* (1992) suggest that auditor's report changes are a way to ensure the audit expectation gap debate is framed in terms of improving the understanding of users rather than a consideration of what the role of the audit should be or to provide more information on the nature and quality of audit performance. Instead of detailing considerations and findings regarding the enterprise as specific outcomes of the particular audit, standard setters had moved towards longer-form audit reports, where the dominant emphasis was on providing information on generalized audit responsibilities. Similarly, Humphrey *et al.* (2009) conclude that the auditor's report contains general, standardized statements on the role and limitations of the audit, but little information about the specific work undertaken and the findings obtained by auditors. These findings call into question whether including such generalized statements or explanations in auditor's reports in addition to the audit opinion may convey any additional value or relevant information for users.

In conclusion, several prior studies suggest that the presence of explanations in an auditor's report may lead to a better understanding of the responsibilities of management and auditors, as well as the nature, scope, and procedures of an audit among users. However, there are also contrasting findings, which suggest that the

effect of such explanations may be rather small, dysfunctional, or even absent. These findings raise some general doubts about the possibility to affect users' perceptions by providing explanations in the auditor's report. Given that previous findings in this respect are mixed, we posit a research question rather than a directional hypothesis to examine whether the presence of the explanations in the ISA 700 auditor's report results in a smaller expectation gap (which could be the case if users pay attention to these explanations and if this leads to a shift of their perceptions toward those of auditors) as compared to the absence of such explanations, i.e. when a short-form opinion-only report is used. The research question is stated in the following three parts:

> **RQ1a:** Does the presence versus absence of the explanations in the unqualified ISA 700 auditor's report result in a smaller difference in perceptions between auditors and financial statement users regarding the extent to which responsibility for the financial statements is ascribed to the auditor?
>
> **RQ1b:** Does the presence versus absence of the explanations in the unqualified ISA 700 auditor's report result in a smaller difference in perceptions between auditors and financial statement users regarding the extent to which responsibility for the financial statements is ascribed to management?
>
> **RQ1c:** Does the presence versus absence of the explanations in the unqualified ISA 700 auditor's report result in a smaller difference in perceptions between auditors and financial statement users regarding the extent to which reliability is ascribed to financial statements?

3. RESEARCH METHOD

3.1 Research design and participants

We conducted a full-factorial two (complete unqualified ISA 700 auditor's report and an unqualified opinion-only version of this report) by three (auditors, financial analysts, and students) between-subjects experiment with participants from Germany. Participating auditors came from one German Big 4 audit firm. Part of the contact details of financial analysts was received from the Bloomberg database. Additional financial analysts were approached through the German Society of Investment

Professionals (DVFA). Finally, students at the Ruhr University Bochum and the University of Münster participated in the study.

3.2 Measurement of the audit expectation gap

The primary dependent variables measuring the overall audit expectation gap are multiple-item constructs adopted from instruments used in prior research (Best *et al*., 2001; Gay *et al*., 1997; Monroe & Woodliff, 1993; Miller *et al*., 1993; Hatherley *et al*., 1991; Holt & Moizer, 1990; Frank *et al*., 2001; Kelly & Mohrweis, 1989), which assess: 1) the extent to which participants ascribe responsibility for the financial statements toward the auditor (*auditor responsibility*), 2) the extent to which participants ascribe responsibility for the financial statements toward management (*management responsibility*), and 3) the extent to which participants ascribe reliability to the audited financial statements (*reliability*). Table 1 illustrates our expectation gap belief scales and items.

<<<Insert Table 1 about here>>>

3.3 Experimental procedure and manipulations

The experiment was conducted as a web-based survey. Participants received an invitation email that provided a link to the survey. The survey was designed with the online survey software Globalpark. This software allows the random distribution of two experimental treatments (complete unqualified ISA 700 auditor's report with explanations versus unqualified audit opinion-only version of this report without explanations) between participants. The survey was provided in German and translated into English for reproduction in the Appendix.

All participants were asked to read a short description of a (fictitious) stock-listed company, followed by summarized financial statement information from two consecutive years. Following this firm-specific information, all participants were shown the auditor's report on the financial statements. In the "opinion-only" condition, participants only read the auditor's opinion, whereas the "complete auditor's report" condition disclosed the complete text of the ISA 700 auditor's report (including the opinion). Hence, the difference between the two conditions was the presence versus absence of the first part of the text of the ISA 700 auditor's report, which contains the explanations of the auditor's (vis-à-vis management's) responsibilities and the nature, scope, and procedures of the audit. We use this

relatively strong manipulation in order to address the doubts regarding the effectiveness of including explanations in the auditor's report, which we base on the mixed findings in prior research. If the gap between auditors and users remains unchanged using a complete ISA 700 auditor's report as compared to a mere opinion-only version, this would be evidence of the ineffectiveness of ISA 700's explanations beyond the audit opinion.[4]

Following the case description, participants responded to several sets of questions relating to the three expectation gap constructs (see Table 1). Within each set, the order of questions was randomized, and the questions were followed by manipulation checks and demographic questions.[5]

4. RESULTS

4.1 Sample demographics

Auditors

We contacted approximately 1,450 Big Four auditors, and a total of 163 auditors participated in the experiment (11.24% response rate). The average auditor was 42.1 years old and had 14.8 years of public accounting experience. Of the sample of auditors, 127 (77.9%) were male. There were 29 partners, three directors, 37 senior managers, 85 managers, and nine senior staff auditors. We asked all participants from

[4] We considered a variety of alternative design choices, including the possibility of using the pre-ISA 700 report instead of the short-form, opinion-only version. We concluded that this possibility was less appropriate for two important reasons. First, with such an approach it would have been impossible to accurately attribute any effects to the specific underlying drivers, since we would have concurrently varied many different factors (because the revision of ISA 700 involved quite a number of different wording changes within the explanations section of the auditor's report), but not the presence/absence of explanations as such that we are interested in (and which is a clear-cut factor). Second, as outlined in the literature review, prior research evidence is mixed, suggesting that the effects of explanations may be rather small, dysfunctional, or even entirely absent. We wished to address this possibility in our research design. If the pre-ISA 700 report had been used as the control condition, finding no effect of the new report would not be informative, because this could be attributed to lack of statistical power. Should, however, no effect be observed with our current design (which also features explicit encouragement of participants to thoroughly read the provided auditor's report and control for participants' reading intensity), we believe this would be strong evidence for a lack of effectiveness of the explanations, because the same (differences in) expectations would be achieved without any additional information beyond the mere audit opinion. Hence, our design choice allows for more informative findings in the case of observing no effects.

[5] After participants moved from one set of questions to a subsequent set, they could not go back and change their previous answers. This was important to ensure that answers to the dependent variables could not subsequently be changed after having read the manipulation check questions. In addition, participants could not go back to the previous page of the auditor's report after they were presented with the questions. In this way, we ensured that participants reported their true perceptions after having been exposed to the auditor's report. Otherwise, they would have been able to match their answers to the detailed explanations contained in the auditor's report, which they might have re-read after knowing the questions.

the different groups to rate which reputation level they believe the audit profession holds. On a scale ranging from 1 (low) to 7 (high), auditors perceived the audit profession to hold a fairly high reputation level (μ=5.45).

Financial analysts

A total of 868 financial analysts were contacted directly, and 105 financial analysts participated in the study (7.14% response rate among the directly contacted analysts).[6] The average financial analyst was 38.2 years old and had 13 years of work experience. Of the financial analysts, 96 (91.4%) were male. There were 32 security analysts, 17 portfolio managers, three fixed-income security analysts, four fixed-income portfolio managers, six directors of research, four chief investment officers, and 37 analysts with other functions. On a scale ranging from 1 (low) to 7 (high), financial analysts held relatively high levels of experience with financial reports (μ=5.11) and knowledge about financial reporting (μ=4.76), while their knowledge about auditing was rather moderate (μ=3.32). Finally, analysts perceived the audit profession to hold a reputation level slightly above the mid-point of the scale (μ=3.68).

Students

Out of 706 students from two German universities, 202 responded to our experimental survey and participated in the study (28.61% response rate). The average student was 24.1 years old and had 0.6 years of general work experience. Of the students, 143 (70.8%) were male. On a scale ranging from 1 (low) to 7 (high), students had moderate overall experience with financial reports (μ=3.56) and knowledge of financial reporting (μ=4.24). Knowledge about auditing was moderate as well (μ=3.37). Finally, students perceived the audit profession to hold a relatively high reputation level (μ=4.87).

4.2 Manipulation checks

To verify the effectiveness of the manipulation of the presence versus absence of the explanations in the auditor's report (i.e., complete auditor's report versus opinion-only), we asked participants two questions after they had completed the experimental survey. First, participants were asked about the extent to which they agreed with the

[6] The number of financial analysts contacted via the German Society of Investment Professionals (DVFA) is unknown to us.

statement "The auditor's report provided in the case materials explicitly described the respective responsibilities of management and auditors." (scale from 1=strongly disagree to 7=strongly agree). The overall mean response was 4.81 for the 'complete report' treatment and 2.20 for the 'opinion-only' treatment. The means are significantly different (p<0.01), indicating successful manipulation. The manipulation check was also successful when conducted separately for each individual user group (i.e., auditors, financial analysts, and students) (largest p=0.000).

Second, participants were asked about the extent to which they agreed with the statement "The auditor's report provided in the materials explicitly described the scope and principles of the auditor's work." (scale from 1=strongly disagree to 7=strongly agree). The overall mean response was 4.52 for the 'complete report' treatment and 2.77 for the 'opinion-only' treatment. The means are significantly different (p<0.01), indicating successful manipulation. The manipulation check was also successful when conducted separately for each individual user group (largest p=0.01).

4.3 Preliminary testing

As previously described, we measured three dimensions of the expectation gap, two of which assess the perceived responsibility for financial reporting (i.e., the management responsibility and auditor responsibility dimensions), while the other gauges the perceived reliability of the audited financial statements. An exploratory factor analysis using all raw items as input variables was performed to verify whether our three underlying theoretical constructs were empirically reproduced as separate factors. This analysis indeed supports the existence of three stable constructs:[7] 1) the responsibility of the auditor for the financial reporting (auditor responsibility), 2) the responsibility of management for the financial reporting (management responsibility), and 3) the reliability of the audited financial statements (reliability). Reliability analyses reveal high Cronbach's alphas (0.85 for auditor responsibility, 0.78 for management responsibility, and 0.86 for financial statement reliability), indicating that all factors measure the underlying construct with a high degree of consistency. Consequently, we tested our hypotheses on the basis of average indices of each of the three constructs, rather than using the individual items.

[7] This outcome is robust using either principal components analysis with varimax rotation that assumes uncorrelated factors or maximum-likelihood analysis with promax rotation, which allows the factors to be correlated.

Furthermore, to reduce the overall experimental error, we included the following covariates in our data analyses (i.e., ANCOVAs and post-hoc mean comparisons): 1) age, 2) gender, 3) self-reported reading intensity of the financial statements, 4) self-reported reading intensity of the auditor's report, and 5) perceived audit profession reputation.[8, 9] Even though not all measured variables are associated with each of the three dependent constructs (see footnote 9) we include them as covariates consistently across all analyses to control as much as possible for the potential demographic variability in our responses. Footnotes to the upcoming analyses indicate whether exclusion of the covariates modifies the results. As shown, when this is the case, the main reported results are more conservative than the footnoted results.

4.4 Hypotheses H1 and H2

H1 predicts that auditors' and financial statement users' perceptions about the ISA 700 auditor's report will differ significantly in terms of three dimensions: 1) the responsibility ascribed to auditors (H1a), 2) the responsibility ascribed to management (H1b), and 3) the reliability ascribed to the audited financial statements (H1c). H2 suggests that all three differences will be relatively greater between students and auditors as compared to financial analysts and auditors. Table 2, 3, and 4 provide adjusted means (Panel A), ANCOVAs (Panel B), and post-hoc mean comparisons (Panel C) for tests of H1a-c and H2a-c.

For tests of H1 and H2, we used only those observations that were provided by respondents in the treatment condition of the 'complete auditor's report,' thus

[8] We did not include experience-related variables as potential covariates, because we largely control for these attributes by splitting the sample into auditors, financial analysts, and students.

[9] First, age is positively correlated with perceived management responsibility and negatively associated with perceived auditor responsibility and financial statement reliability (all *p's*<0.01). Second, gender is significantly associated with perceived management responsibility ($p<0.01$), such that men's mean perception rating is higher (6.63) than women's mean rating (6.41). Third, we asked participants how intensively they read the financial statements (1=did not read them/skipped them; 2=scanned them/read them diagonally; 3=read them fairly thoroughly (word by word/number by number); and 4=read them very thoroughly (e.g., several times/tried to memorize)). This measure is not correlated with any of the three dependent variables. Fourth, using the same scale, we asked participants how intensively they read the auditor's report. This measure is positively correlated with the dependent measure of perceived management responsibility and negatively correlated with perceived auditor responsibility (both *p's*<0.05). Finally, we asked participants about their perceived audit profession reputation on a 7-point scale (ranging from 1=low to 7=high). This measure is negatively correlated with perceived auditor responsibility ($p<0.01$), positively correlated with perceived management responsibility ($p<0.01$), and negatively correlated with perceived financial statement reliability ($p<0.05$); hence we control for it in all upcoming analyses.

omitting the 'opinion-only' data.[10] The reasoning behind this design choice is that H1 and H2 relate to differences in perceptions regarding the report as prescribed by ISA 700 (i.e., the complete report including the explanations). Upcoming tests of RQ1 (see Tables 5, 6, and 7) will incorporate all the responses, i.e. including the data from participants in the treatment condition of the 'opinion-only' version of the report.

Auditor responsibility (H1a and H2a)

We conducted an ANCOVA with 'group' (auditor, financial analyst, and student) as the independent variable and the 'auditor responsibility' index as the dependent variable (see Table 2, Panel B). There is a significant difference between user groups regarding the responsibility ascribed to auditors (p<0.001). Post-hoc mean comparisons (see Table 2, Panel C) reveal that the auditors' mean responsibility rating of 1.58 is significantly lower than the mean responsibility ratings of both financial analysts (4.13) and students (3.99) (p<0.001).[11,12] These findings clearly support H1a, such that users ascribe greater responsibility for the financial statements to auditors, in comparison to auditors themselves. Further, the difference in ascribed auditor responsibility between students and auditors (Δ=2.41) is statistically equivalent to the difference between financial analysts and auditors (Δ=2.55) (difference-in-difference not significant; *t-statistic*=0.50; p=0.31; one-tailed).[13] As such, the results are not consistent with H2a, which predicted that students' ratings would differ more from auditors' ratings than those of financial analysts.

<<<Insert Table 2 about here>>>

Management responsibility (H1b and H2b)

Next, we conducted an ANCOVA with 'group' as the independent variable and the 'management responsibility' index as the dependent variable (see Table 3, Panel B). There is a significant difference between user groups regarding the responsibility ascribed to management (p<0.01). Post-hoc mean comparisons reveal that the

[10] As a result, the number of observations for testing H1 and H2 is 124 for auditors, 39 for financial analysts, and 57 for students.

[11] There is no significant difference between the mean ratings provided by financial analysts and students (p=0.63).

[12] Results are equivalent when omitting covariates from the ANCOVA model and post-hoc analyses.

[13] When omitting covariates from the difference-in-difference analysis (hence, employing raw means rather than adjusted means), the difference between auditors and students (Δ=2.41) is significantly smaller than the difference between auditors and financial analysts (Δ=2.74; *t-statistic*=1.83; p=0.03; one-tailed), but since the difference is rather trivial and is only observed in the ANOVA model without the control variables, we do not discuss it at further length.

auditors' mean responsibility rating of 6.76 is not significantly different from the mean responsibility rating of financial analysts (6.68; p=0.516) but is significantly higher than students' mean rating (6.29; p<0.01). The difference between the mean responsibility rating of financial analysts and students is also significant (p<0.01).[14] These findings partially support H1b in that students (but not financial analysts) ascribe lower responsibility to management, in comparison to auditors. The difference in ascribed management responsibility between students and auditors (Δ=0.47) is significantly greater than the difference between financial analysts and auditors (Δ=0.08; *t-statistic*=3.01; p=0.00; one-tailed).[15]

<<<Insert Table 3 about here>>>

Financial Statement Reliability (H1c and H2c)

To test Hypotheses H1c and H2c, we conducted an ANCOVA with 'group' as the independent variable and the 'financial statement reliability' index as the dependent variable (see Table 4, Panel B). There is a marginally significant effect of user group on financial statement reliability (p<0.10). Post-hoc mean comparisons (see Panel C) show that the auditors' mean financial statement reliability rating of 3.89 is marginally lower than the mean reliability rating provided by students (4.51; p<0.10) but is not significantly different from financial analysts' mean reliability rating (3.92; p=0.922). These findings partially support H1c, such that students (but not financial analysts) ascribe greater reliability to audited financial statements than do auditors. Again, the results also support H2c, because the difference in perceived financial statement reliability between students and auditors (Δ=0.62) is significantly greater than the difference between financial analysts and auditors (Δ=0.03; *t-statistic*=2.10; p=0.02; one-tailed).[16]

4.5 Research question 1: Effect of explanations

RQ1 examines whether the presence (versus absence) of explanations in the unqualified ISA 700 auditor's report reduces the difference in perceptions between

[14] Results are equivalent when omitting covariates from the ANCOVA model and post-hoc analyses, with the exception that the difference between auditors and financial analysts is then also marginally significant (p<0.10).

[15] Results are equivalent when omitting covariates from the difference-in-difference analysis.

[16] Results are equivalent when omitting covariates from the ANCOVA model, the post-hoc comparisons, and the difference-in-difference analysis, with the exception that the significance levels for the group main effect (p<0.01) and the difference between auditor and student ratings (p<0.05) are greater.

auditors and users in terms of responsibility ascribed to the auditor (RQ1a), responsibility ascribed to management (RQ1b), and reliability ascribed to the audited financial statements (RQ1c). Again, we conducted different ANCOVAs, one for each dimension of the expectation gap. However, this time, we added the 'opinion-only' data and included the auditor's report type (complete report [i.e. with explanations] versus opinion-only report [i.e. without explanations]) as a second factor in each model. Tables 5, 6, and 7 present means (adjusted for covariates) and ANCOVAs for tests of RQ1.

Auditor responsibility

We conducted an ANCOVA with 'group' (auditor versus financial analyst versus student) and 'auditor's report type' (complete report versus opinion-only) as the independent variables and the 'auditor responsibility' index as the dependent variable. Table 5 presents the adjusted means per treatment condition (Panel A) and the ANCOVA results (Panel B). As shown in Panel B, neither the main effect of the auditor's report type (p=0.765) nor the interaction effect between group and auditor's report type (p=0.446) on auditor responsibility ratings are significant. However, non-tabulated simple mean comparisons of the significant group effect (p=0.000) reveal that auditors' (adjusted) mean 'auditor responsibility' rating (1.74) remains significantly lower than both financial analysts' (4.10) and students' mean rating (3.93), also when including the 'opinion-only' treatment data in the study sample (both p's<0.001).[17] In conclusion, our results suggest that the presence (versus absence) of explanations in the ISA 700 auditor's report does not affect the gap in perceptions between auditors and users regarding the auditor's responsibility.

<<<Insert Table 5 about here>>>

Management responsibility

Next, we conducted an ANCOVA with 'group' and 'auditor's report type' as the independent variables and the 'management responsibility' index as the dependent variable. Table 6 presents the adjusted means per treatment condition (Panel A) and the ANCOVA results (Panel B). Again, the only significant effect is the main effect of group (p<0.001), such that auditors rank the level of management's responsibility marginally higher (6.87) than financial analysts (6.75; p<0.10) and significantly

[17] Results are equivalent when omitting covariates from the ANCOVA model.

higher than students (6.26; p<0.001) do. The main effect of the report type and the interaction effect are both insignificant.[18] In conclusion, our results suggest that the presence (versus absence) of explanations in the ISA 700 auditor's report does not affect the gap in perceptions between auditors and users regarding the management's responsibility.

<<<Insert Table 6 about here>>>

Financial statement reliability

To examine RQ1c, we conducted an ANCOVA with 'group' and 'auditor's report type' as the independent variables and the 'financial statement reliability' index as the dependent variable. Table 7 reports the adjusted means per treatment condition (Panel A) and the ANCOVA results (Panel B). Neither the two main effects nor the interaction effect are significant (smallest p=0.346). Hence, the presence (versus absence) of the explanations in the ISA 700 auditor's report does not bring users' reliability ratings closer to the auditors' ratings.[19]

<<<Insert Table 7 about here>>>

At least to the extent that auditor perceptions can be used as a "benchmark" for normative perceptions of management and auditor responsibilities and financial statement reliability, our results do not suggest that the presence of the ISA 700 explanations of management's and auditor's respective responsibilities and of the nature, scope, and procedures of the audit in the complete auditor's report affects the expectation gap. In contrast, we find a similar gap in perceptions when the complete report with its detailed explanations is provided as when a report with the mere audit opinion is provided.

5. DISCUSSION AND CONCLUSIONS

Over 70 jurisdictions around the world have adopted the ISAs, and several additional implementations are pending, most notably in the EU and China. These developments reinforce the need for further empirical evidence on international users' perceptions of ISA 700, which is one of the most important standards with respect to enhancing

[18] Results are equivalent when omitting covariates from the ANCOVA model, except that the difference between auditors and financial analysts is greater (p<0.05).

[19] When omitting covariates from the ANCOVA model, the group main effect turns significant (p=0.001), and non-tabulated mean comparisons reveal that students' unadjusted mean (4.31) is significantly greater than both auditors' unadjusted mean (4.02; p<0.05) and financial analysts' unadjusted mean (3.77; p<0.001).

investors' confidence in financial reporting. Given permanent revisions of current standards to address changing investor needs, empirical evidence on user perceptions is a crucial means of providing insight into possible needs and directions for standard revisions. Because individual jurisdictions plan to adopt and build on the existing ISA 700, such as the EU or national standard-setters, high-quality standards are an important condition for consistency and standard-setting transparency.

Prior research has repeatedly indicated the existence of an expectation gap between auditors (who are knowledgeable about the purpose and implications of an audit) and users regarding the reliability of audited financial statements and the respective responsibilities that managers and auditors assume. This phenomenon has been demonstrated across time and national borders, and even despite various institutional changes to narrow the gap. Indeed, the revised ISA 700 auditor's report represents one such attempt. Hence, this study was conducted to empirically assess the current state of the expectation gap under the revised ISA 700 by inquiring a sample of German auditors and financial statement users.

Consistent with our prediction, we found that users ascribed far greater responsibility for the financial statements to auditors (well above the midpoint of the scale) as compared to auditors, who ascribed almost no responsibility to their own profession. Although we expected a greater gap between auditors and students when compared to the gap between auditors and analysts, the results are not significant in this regard. These findings are in line with recent US literature on the audit expectation gap, where Reckers *et al.* (2007) found that auditors' attitudes toward the public accounting profession were more favourable than those of judges, law students, and MBA students, and where Butler *et al.* (2010) identified important differences between auditors' and investors' perceptions of the intended meanings of key terms used to define auditors' responsibilities.

Considering the assessment of management's responsibility, we observed a gap between auditors and users, which was driven by a somewhat lower rating by the group of less experienced financial statement users (students). However, it is important to note that all three groups assigned a relatively high level of responsibility (all means greater than 6 on a 7-point scale) to management, indicating a clear narrowing of the expectation gap in this regard as compared to prior research. Finally, with respect to perceived financial statement reliability, all three groups provided a moderately high ranking (around 4 on a 7-point scale), though students rated

reliability somewhat higher than auditors and analysts. Again, we conclude that the gap in this dimension is relatively minor.

These findings suggest that the audit expectation gap persists but appears to be largely driven by discrepant expectations between auditors and users regarding the formal responsibilities and abilities of the auditor. However, the gap is smaller with regard to management responsibilities and the perceived reliability of audited financial statements.

We further investigated the effect of the explanations provided in the ISA 700 auditor's report by comparing user perceptions based on the complete report that contained these explanations versus an opinion-only version that did not. This approach allowed us to test whether or not the presence of the explanations mandated by the revised ISA 700 would lead to an alignment of users' perceptions toward those of auditors. Our results suggest that despite the underlying objective of the revised ISA 700 auditor's report, the presence of the (quite extensive) ISA 700 explanations does not affect the expectation gap.

This study has some limitations that should be acknowledged. First, a maintained assumption is that auditors' perceptions can be considered a benchmark for the normative responsibilities and financial statement reliability. Though auditors are likely to have self-interest and may also respond strategically to questions regarding their own responsibilities, we suggest that it is plausible to assume that auditors are the best profession available to use as a benchmark in this regard, due to their in-depth knowledge of the audit process. Indeed, this is a maintained assumption in most prior empirical research on the audit expectation gap. Second, our study is limited to comparing the perceptions of auditors, financial analysts, and students, and we acknowledge that there may be other stakeholders whose perceptions are also important to consider.[20] Finally, to judge whether there has been a true change in perceptions, some might argue that the pre-ISA 700 auditor's report would be a more suitable alternative condition than our opinion-only version of the ISA 700 auditor's report that excludes all explanations. However, as discussed extensively in footnote 4, this alternative design would have involved severe problems and losing the particular benefits of our design choice.

[20] See e.g. Ruhnke *et al.* (2010) for survey based evidence on general expectations regarding the auditor's work of some additional stakeholder groups in Germany, including university professors, business press journalists, or bank officers.

Overall, while the fact that an audit expectation gap still exists under the new ISA 700 auditor's report is in line with our expectations, it is disconcerting that the (quite detailed) explanations of auditor versus management responsibilities and of the nature, scope, and procedures of the audit do not favourably affect the gap. This observation may indicate that the explanations would need to be formulated more explicitly and clearly, or even that user' perceptions are not malleable by additional explanations in the auditor's report. The latter concern is also supported by a recent qualitative study by Mock *et al.* (2011), which similarly suggests that financial statement users only consider the actual audit opinion (as long as it is unqualified) as the relevant signal but that they disregard the long text of the report and the explanations included beyond the opinion itself. This may suggest that wording changes are not the solution needed to overcome the expectation gap, possibly because users' expectations are determined by rather stable preconceptions.[21] At this stage, however, any specific recommendations are speculative and require further research for validation.

[21] For a general discussion on the clarity of audit standards see Dennis (2010a).

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Table 1
Expectation Gap Belief Scales

Panel A: Auditor Responsibility Factor (Cronbach's alpha = 0.851) *(all item scales range from 1=strongly disagree to 7=strongly agree)*
According to my impression…
…the auditor is responsible for detecting all fraud
…the auditor is responsible for the soundness of the internal control structure of the entity.
…the auditor is responsible for maintaining accounting records.
…the auditor is responsible for producing the financial statements.
…the auditor is responsible for preventing fraud.
Panel B: Management Responsibility Factor (Cronbach's alpha = 0.753) *(all item scales range from 1=strongly disagree to 7=strongly agree)*
According to my impression…
…management is responsible for detecting all fraud.
…management is responsible for the soundness of the internal control structure of the entity.
…management is responsible for maintaining accounting records.
…management is responsible for producing the financial statements.
…management is responsible for preventing fraud.
Panel C: Financial Statement Reliability Factor (Cronbach's alpha = 0.860) *(all item scales range from 1=strongly disagree to 7=strongly agree)*
Users can have absolute assurance that the financial statements contain no material misstatements.
The audited financial statements give a true and fair view of the financial position of the entity.
The entity is free from fraud.
The audited financial statements comply with accepted accounting practice.
The audited financial statements contain no deliberate distortions.
The audited financial statements contain no accidental errors.
The audited financial statements have no significant omissions.
The amounts and disclosures contained in the audited financial statements are credible.
The company has kept proper accounting records during the year.

Table 2
Test of H1a and H2a (Auditor Responsibility Index)

Panel A: Adjusted Means for Auditor Responsibility Index

Group	Mean	S.E.	N
Auditor	1.58	0.19	71
Financial Analyst	4.13	0.19	47
Student	3.99	0.17	95

Panel B: ANCOVA Results for Auditor Responsibility Index

Source	Type III Sum of Squares	df	Mean Square	F-Value	p-value
Corrected Model	323.61	7	46.23	33.92	0.000
Group	149.02	2	74.51	54.66	**0.000**
Covariates:					
Age	0.00	1	0.00	0.00	0.99
Gender	0.54	1	0.54	0.40	0.528
Self-reported reading intensity of financial statements	0.79	1	0.79	0.58	0.446
Self-reported reading intensity of auditor's report	5.65	1	5.65	4.15	**0.043**
Perceived audit profession reputation	7.02	1	7.02	5.15	**0.024**
Error	279.44	205	1.36		

Panel C: Post-hoc Mean Comparisons (Least Significant Difference)

			S.E.	p-value
Auditor	vs.	Financial Analyst	0.25	**0.000**
Auditor	vs.	Student	0.31	**0.000**
Financial Analyst	vs.	Student	0.28	0.626

Table 3
Test of H1b and H2b (Management Responsibility Index)

Panel A: Adjusted Means for Management Responsibility Index

Group	Mean	S.E.	N
Auditor	6.76	0.09	71
Financial Analyst	6.68	0.09	47
Student	6.29	0.08	95

Panel B: ANCOVA Results for Management Responsibility Index

Source	Type III Sum of Squares	df	Mean Square	F-Value	p-value
Corrected Model	21.75	7	3.11	9.58	0.000
Group	3.68	2	1.84	5.67	**0.004**
Covariates:					
Age	1.01	1	1.01	3.13	**0.079**
Gender	0.01	1	0.01	0.02	0.888
Self-reported reading intensity of financial statements	0.79	1	0.79	2.43	0.120
Self-reported reading intensity of auditor's report	0.09	1	0.09	0.28	0.596
Perceived audit profession reputation	1.19	1	1.19	3.66	**0.057**
Error					

Panel C: Post-hoc Mean Comparisons (Least Significant Difference)

			S.E.	p-value
Auditor	vs.	Financial Analyst	0.12	0.516
Auditor	vs.	Student	0.15	**0.002**
Financial Analyst	vs.	Student	0.14	**0.004**

Table 4
Test of H1c and H2c (Financial Statement Reliability Index)

Panel A: Adjusted Means for Financial Statement Reliability Index

Group	Mean	S.E.	N
Auditor	3.89	0.20	71
Financial Analyst	3.92	0.20	47
Student	4.51	0.18	95

Panel B: ANCOVA Results for Financial Statement Reliability Index

Source	Type III Sum of Squares	df	Mean Square	F-Value	p-value
Corrected Model	28.69	7	4.10	2.80	0.008
Group	6.98	2	3.49	2.38	**0.095**
Covariates:					
Age	0.23	1	0.23	0.16	0.692
Gender	6.99	1	6.99	4.77	**0.030**
Self-reported reading intensity of financial statements	3.30	1	3.30	2.25	0.135
Self-reported reading intensity of auditor's report	0.06	0	0.06	0.04	0.840
Perceived audit profession reputation	2.20	1	2.20	1.50	0.222
Error	300.70	205	1.47		

Panel C: Post-hoc Mean Comparisons (Least Significant Difference)

			S.E.	p-value
Auditor	vs.	Financial Analyst	0.26	0.922
Auditor	vs.	Student	0.32	**0.059**
Financial Analyst	vs.	Student	0.29	**0.043**

Table 5
Test of RQ1a (Auditor Responsibility Index)

Panel A: Adjusted Means for Auditor Responsibility Index

Group	Report Type	Mean	S.E.	N
Auditor	Opinion-only	1.75	0.14	86
	Complete	1.72	0.16	71
	Overall	1.74	0.12	157
Financial Analyst	Opinion-only	4.03	0.16	56
	Complete	4.17	0.17	47
	Overall	4.10	0.13	103
Student	Opinion-only	4.03	0.14	105
	Complete	3.83	0.14	95
	Overall	3.93	0.11	200
Overall	Opinion-only	3.27	0.08	247
	Complete	3.24	0.08	213
	Overall	3.26	0.06	460

Panel B: ANCOVA Results for Auditor Responsibility Index

Source	Type III Sum of Squares	df	Mean Square	F-Value	p-value
Corrected Model	719.89	10	71.99	58.17	0.000
Group	294.67	2	147.34	119.05	**0.000**
Report Type	.11	1	.11	.09	0.765
Group x Report Type	2.00	2	1.00	.81	0.446
Covariates:					
Age	3.64	1	3.64	2.94	*0.087*
Gender	.60	1	.60	.48	0.487
Self-reported reading intensity of financial statements	.24	1	.24	.19	0.661
Self-reported reading intensity of auditor's report	3.19	1	3.19	2.58	0.109
Perceived audit profession reputation	17.25	1	17.25	13.94	**0.000**
Error	555.69	449	1.24		

Table 6
Test of RQ1b (Management Responsibility Index)

Panel A: Adjusted Means for Management Responsibility Index

Group	Report Type	Mean	S.E.	N
Auditor	Opinion-only	6.91	0.07	86
	Complete	6.84	0.07	71
	Overall	6.87	0.06	157
Financial Analyst	Opinion-only	6.81	0.07	56
	Complete	6.69	0.08	47
	Overall	6.75	0.06	103
Student	Opinion-only	6.28	0.06	105
	Complete	6.24	0.06	95
	Overall	6.26	0.05	200
Overall	Opinion-only	6.66	0.03	247
	Complete	6.59	0.04	213
	Overall	6.63	0.03	460

Panel B: ANCOVA Results for Management Responsibility Index

Source	Type III Sum of Squares	df	Mean Square	F-Value	p-value
Corrected Model	48.69	10	4.87	18.61	0.000
Group	13.00	2	6.50	24.84	**0.000**
Report Type	0.60	1	0.60	2.31	0.130
Group x Report Type	0.10	2	0.05	0.19	0.826
Covariates:					
Age	0.16	1	0.16	0.60	0.441
Gender	1.34	1	1.34	5.12	**0.024**
Self-reported reading intensity of financial statements	0.37	1	0.37	1.43	0.232
Self-reported reading intensity of auditor's report	0.46	1	0.46	1.74	0.188
Perceived audit profession reputation	0.72	1	0.72	2.76	**0.099**
Error	117.50	449	0.26		

Table 7
Test of RQ1c (Financial Statement Reliability Index)

Panel A: Adjusted Means for Financial Statement Reliability Index

Group	Report Type	Mean	S.E.	N
Auditor	Opinion-only	4.14	0.16	86
	Complete	4.07	0.17	71
	Overall	4.11	0.13	157
Financial Analyst	Opinion-only	3.94	0.18	56
	Complete	3.94	0.19	47
	Overall	3.94	0.14	103
Student	Opinion-only	4.06	0.15	105
	Complete	4.35	0.15	95
	Overall	4.20	0.12	200
Overall	Opinion-only	4.05	0.08	247
	Complete	4.12	0.09	213
	Overall	4.08	0.06	460

Panel B: ANCOVA Results for Financial Statement Reliability Index

Source	Type III Sum of Squares	df	Mean Square	F-Value	p-value
Corrected Model	33.60	10	3.36	2.23	0.015
Group	2.95	2	1.48	0.98	0.376
Report Type	0.55	1	0.55	0.37	0.546
Group x Report Type	3.20	2	1.60	1.06	0.346
Covariates:					
Age	2.89	1	2.89	1.92	0.167
Gender	1.12	1	1.12	0.75	0.388
Self-reported reading intensity of financial statements	0.02	1	0.02	0.02	0.902
Self-reported reading intensity of auditor's report	3.93	1	3.93	2.61	0.107
Perceived audit profession reputation					
Error	676.00	449	1.51		

APPENDIX
Experimental Case with Auditor's Report Manipulation ('Opinion-only' Versus 'Complete Report')[*]

In the following, you will obtain information about Berens Electronics AG and the auditor's report of its financial statements auditor. Upon reading the case, you will be asked a set of questions.

Berens Electronics AG
Berens Electronics is a large publicly traded company that manufactures and distributes audio, video, and other multimedia equipment to retailers throughout Europe.

Berens Electronics has completed the fiscal year 2007 and published the IFRS consolidated financial statements, which are outlined in the following:

Berens Electronics AG
Consolidated Balance Sheet

	12/31/2007 in million €	**12/31/2006 in million €**
Non-Current Assets	600	596
Current Assets	490	479
Thereof cash and cash equivalents	*156*	*150*
Thereof accounts receivables	*191*	*189*
Thereof inventory	*143*	*140*
TOTAL ASSETS	**1,090**	**1,075**
Equity	640	638
Liabilities	450	437
TOTAL EQUITY AND LIABILITIES	**1,090**	**1,075**

Berens Electronics AG
Consolidated Income Statement

	2007 in million €	**2006 in million €**
Sales	1,300	1,181
Cost and expenses	1,201	1,084
OPERATING PROFIT	99	97
Financial income and expenses	2	1
PROFIT BEFORE TAX	101	98

Berens Electronics' financial statements have been audited by the audit firm G&B for the preceding three years. G&B is a large audit firm with a good reputation.

In the following, this year's auditor's report of G&B relating to the audit of this year's IFRS consolidated financial statements according to International Standards on Auditing (ISA) is reproduced:

[*] The original versions used in this study were in German Here, we provide an English translation.

[--- Experimental Manipulation ---]
[The following text was shown in the 'complete report' auditor's report condition:]

Independent Auditor's Report

To Berens Electronics AG

We have audited the accompanying consolidated financial statements for the year from January 1st, 2007 to December 31st, 2007.

Management's Responsibility for the Financial Statements
The management of the company is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. This responsibility includes:
- designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of the financial statements, which are to be free from material misstatement, whether due to fraud or error;
- selecting and applying appropriate accounting policies;
- and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility
Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance that the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making these risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonability of accounting estimates made by management as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the financial statements give a true and fair view of the financial position of Berens Electronics AG, as of December 31st, 2007, and of its financial performance and cash flows for the year from January 1st, 2007 to December 31st, 2007, in accordance with International Financial Reporting Standards.

G&B
(Public Accounting Firm)

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[The following text was shown in the 'opinion-only' auditor's report condition:]

Independent Auditor's Report

To Berens Electronics AG

We have audited the accompanying consolidated financial statements for the year from January 1st, 2007 to December 31st, 2007.

[…]

Opinion
In our opinion, the financial statements give a true and fair view of the financial position of Berens Electronics AG, as of December 31st, 2007 and of its financial performance and cash flows for the year from January 1st, 2007 to December 31st, 2007 in accordance with International Financial Reporting Standards.

G&B
(Public Accounting Firm)

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